PRIVATE EQUITY INVESTMENT IN PRIVATE EDUCATION

Itqan Capital discusses the growing investment in the Mena private education sector

Private equity – as an asset class – has continued to receive different reactions from investors and intending investors as a result of its long term nature. This has made discerning investors screen the business sectors their funds wish to invest in to ensure safety of capital and optimal returns on their investment.

The main sectors in the Mena region for private equity investment remain those generally perceived as resistant to changes in the economic cycle. ‘Defensive’ sectors include healthcare, education, food & beverages and consumer-related businesses. These sectors, to some extent, can provide constant dividends and stable earnings irrespective of the general state of the market.

They are also known as ‘non-cyclical’ sectors because during recession or market contraction, they tend to outperform the rest in the market. Although some private equity funds remain sector agnostic, whereby a number of key players invest across a wide range of sectors, an increasing number are developing a sector focus in order to create a brand identity and differentiate themselves from other investors.

Investment in the Mena private education sector and namely in the private K-12 segment is perceived attractive by many discerning private equity investors. Revenues in the sector are quite viable and predictable as private schools that provide acceptable quality and value for tuition fees enjoy average student retention period of three to five years. Also, the sector is capital intensive with high barriers to entry.

With soaring land prices, acquiring land in a good location is a challenge. Here private equity investment plays the pivotal role in funding the physical asset costs. Usually land is purchased or leased by the Private Equity investment through the Property Company (PropCo) while the Operating Company (OpeCo) provides operating expertise. It is within the market norms that the Operator who acts as the education

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manager to own a share of OpCo while the rest is financed through the private equity investment.

The education market in the Mena region is expected to reach US$96bn by 2015. The public and private education market in the GCC region alone is expected to be worth US$61bn by the same year. Since demand in the Mena education sector, especially the richer ones, outnumber the supply, private equity firms are getting involved to bridge the gap between the demand and the supply through private schools. Similar to the rest of emerging markets, what is driving growth in private education within Mena is quality as private education is perceived to be of higher quality than public education. Usually private schools in the region provide higher quality English education which is a main attraction for parents. As a result of the economic development, the unprecedented increase in energy prices and the increase in the regional GDP per capita income, parents are currently aware of the importance of private education and more importantly can afford it.

In Saudi Arabia, it could be argued that private education is one of the most attractive markets in the GCC region for private equity Investors, perhaps even the world. It represents the largest education base in the GCC region as 75% of total students in the GCC general education (K-12) system are in Saudi.

Demand for private and international schools has increased in recent years driven by the improved quality of education, which is reflected in the academic performance of these schools as compared to government-run schools. Another aspect is the expatriate community; the growth in the expatriate population across Saudi Arabia has contributed to this surge as children of expatriate parents are not admitted into government-run schools. The private school market of Saudi Arabia had a size of US$2.24bn in 2010 in terms of annual tuition fees which is continuously growing making it one of the most lucrative sectors. It should also be noted that between 2008 and 2011, Private K12 enrolment grew by 9%, whereas the public K12 enrolment grew by 1%, highlighting the growing interest of the local population in private education. While the number of schools and school chains eligible to offer the international curriculum increased from 12 in 2007 to 32 in 2011, enrolment in international schools increased at a CAGR of 12% during the same period.

The trend in government support has been apparent for the past several years, with enhanced government budgets that have accompanied the development of general education. There has been an apparent upward trend in the budgetary allocations on education by the government, which emphasizes how the kingdom believes that education is necessary for sustained economic development, as it enhances both human capital and knowledge. In late 2013, the Saudi government announced its budget for 2014 with an all-time high spending of US$56bn on education and training. Public spending for education in Saudi is estimated at 5.7% of the country’s gross domestic product (GDP) which is higher than that of the UK - 5.3%, Germany - 4.3%, and South Korea - 4.2%.

From above, the Mena region and mainly Saudi Arabia are witnessing a robust interest and signs of growth in the private education market across all segments and mainly the K-12 market. The sector is still promising, with limited competition. This translates to opportunities for both private equity investors as well as school operators. Because investment opportunities vary across the region, it is important for private equity investors to correctly target the geography, market segment, investment strategy and operator before they invest.

To meet the demand for private education in the region, Itqan Capital, a Jeddah based Saudi Investment Company has announced the launch of a US$200m private equity fund focusing on K-12 education within this region primarily by establishing new private schools within the region.

Itqan Capital is licensed by the Capital Market Authority and aspires to be the Kingdom’s preeminent provider of investment offerings to pension funds, foundations, charity organisations, endowments, private and public companies, high-net-worth individuals, and family offices. Itqan Capital is a member of Al Baraka Banking Group, an international Islamic bank headquartered in the Kingdom of Bahrain with presence in 15 countries, 450 branches, and total assets in excess of $19bn. Al Baraka is rated BBB- (long-term) and A-3 (short-term) by Standard & Poor’s and is listed on the Bahrain and NASDAQ Dubai stock exchanges.

“IN SAUDI ARABIA, PRIVATE EDUCATION IS ARGUABLY ONE OF THE MOST ATTRACTIVE MARKETS IN THE GCC REGION FOR PRIVATE EQUITY INVESTORS”

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